

BEFORE THE TENNESSEE STATE BOARD OF EQUALIZATION

IN RE: Net Magan Land Owner One, LP)
Ward 073, Block 101, Parcel 00827) Shelby County
Industrial Property)
Tax Year 2006)

INITIAL DECISION AND ORDER

Statement of the Case

The subject property is presently valued as follows:

<u>LAND VALUE</u>	<u>IMPROVEMENT VALUE</u>	<u>TOTAL VALUE</u>	<u>ASSESSMENT</u>
\$465,000	\$1,279,100	\$1,744,100	\$697,640

An appeal has been filed on behalf of the property owner with the State Board of Equalization. The undersigned administrative judge conducted a hearing in this matter on June 20, 2007 in Memphis, Tennessee. In attendance at the hearing were registered agent Jim Schwalls and Shelby County Property Assessor's representative Rick Middleton, TCA.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Subject property consists of a 5.71 acre site improved with a 110,173 square foot distribution warehouse constructed in 1978 located at 3993 Crowfarn Drive in Memphis, Tennessee.

Subject property was historically 100% occupied by University Games Corp. [“UGC”] pursuant to a lease which commenced on March 1, 1999. UGC vacated the property on February 28, 2005. The taxpayer subsequently leased 40,000 square feet to API on a month-to-month basis for \$1.35 per square foot (gross) beginning on October 1, 2005. On September 1, 2006 a lease commenced with Memphis Distribution Service for all 110,173 square feet at a face rate of \$1.63 per square foot.¹ The lease runs through November 30, 2016.

The taxpayer contended that subject property should be valued at \$1,320,000. In support of this position, the income approach was introduced into evidence.

The assessor contended that subject property should remain valued at \$1,744,100. In support of this position, the income approach was introduced into evidence. In addition, Mr. Middleton's analysis included summaries of several sales he maintained support the current appraisal of subject property. Finally, Mr. Middleton introduced a spreadsheet (as part of collective exhibit #2) comparing the sales prices of eight similar type properties to the assessor's appraised values. Mr. Middleton asserted the spreadsheet demonstrated that the assessor's appraisals are typically somewhat conservative.

The basis of valuation as stated in Tennessee Code Annotated Section 67-5-601(a) is that "[t]he value of all property shall be ascertained from the evidence of its sound, intrinsic

¹ The taxpayer estimated the effective rental rate at \$1.46 per square foot.

and immediate value, for purposes of sale between a willing seller and a willing buyer without consideration of speculative values . . ."

General appraisal principles require that the market, cost and income approaches to value be used whenever possible. Appraisal Institute, *The Appraisal of Real Estate* at 50 and 62. (12th ed. 2001). However, certain approaches to value may be more meaningful than others with respect to a specific type of property and such is noted in the correlation of value indicators to determine the final value estimate. The value indicators must be judged in three categories: (1) the amount and reliability of the data collected in each approach; (2) the inherent strengths and weaknesses of each approach; and (3) the relevance of each approach to the subject of the appraisal. *Id.* at 597-603.

The value to be determined in the present case is market value. A generally accepted definition of market value for ad valorem tax purposes is that it is the most probable price expressed in terms of money that a property would bring if exposed for sale in the open market in an arm's length transaction between a willing seller and a willing buyer, both of whom are knowledgeable concerning all the uses to which it is adapted and for which it is capable of being used. *Id.* at 21-22.

In view of the definition of market value, the income-producing nature of the subject property and the age of subject property, generally accepted appraising principles would indicate that the market and income approaches have greater relevance and should normally be given greater weight than the cost approach in the correlation of value indicators.

After having reviewed all the evidence in the case, the administrative judge finds that the subject property should be valued at \$1,615,600 pursuant to the income approach. Respectfully, the administrative judge finds that the assessor's comparable sales lack probative value because they were not adjusted.

The administrative judge finds that both parties' income approaches assumed operating expenses equal to 15¢ per square foot and a capitalization rate of 9.75%. As will be discussed below, the two primary differences between the parties' income approaches concerned potential gross income and Mr. Schwalls' contention that a \$128,500 deduction should be made from the stabilized indication of value to account for lost income during the lease-up period.

The administrative judge finds that the only other area of "disagreement" between the parties dealt with vacancy and credit loss. The administrative judge finds that Mr. Middleton actually assumed a somewhat higher rate (15% vs. 12%) and the proof supports adoption of that rate.

With respect to potential gross income, Mr. Schwalls assumed a base rental rate of \$1.63 per square foot in accordance with the previously summarized lease which commenced on September 1, 2006. Mr. Middleton, in contrast, assumed a market rental

rate of \$2.00 per square foot based upon the assessor's valuation model for large "B" grade warehouses.

The administrative judge finds that Mr. Schwalls' proposed market rental rate of \$1.63 per square foot must be rejected absent additional evidence. The administrative judge finds that January 1, 2006 constitutes the relevant assessment date pursuant to Tenn. Code Ann. § 67-5-504(a). The administrative judge finds the lease was signed long after January 1, 2006 and is therefore irrelevant. See *Acme Boot Company and Ashland City Industrial Corporation* (Cheatham County - Tax Year 1989) wherein the Assessment Appeals Commission ruled that "[e]vents occurring after [the assessment] date are not relevant unless offered for the limited purpose of showing that assumptions reasonably made on or before the assessment date have been borne out by subsequent events." Final Decision and Order at 3. Moreover, the administrative judge finds that no rent comps were introduced to establish market rental rates. Finally, the administrative judge finds that for all practical purposes Mr. Schwalls has appraised the leased fee estate rather than the fee simple estate as required by Tennessee law. See *First American National Bank Building Partnership* (Davidson Co., Tax Years 1984-1987) wherein the Assessment Appeals Commission ruled that it "is the entire fee simple unencumbered value and not any lesser or partial interests" which is normally subject to taxation.² Final Decision and Order at 3. Absent additional proof, the administrative judge must presume Mr. Middleton's assumed rental rate of \$2.00 per square foot reflects market rent.

The final issue before the administrative judge concerns rent loss during the lease-up period. The administrative judge previously addressed this issue in *Farnsworth Industrial Properties* (Shelby Co., Tax Year 2005). That decision is appended to this order for ease of reference and hereby incorporated by reference. For the reasons stated therein, the administrative judge finds such a deduction appropriate.

Absent additional evidence, the administrative judge will utilize Mr. Schwalls' analysis on this issue. The administrative judge recognizes that an assumed rental rate of \$2.00 per square feet results in a greater rent loss than the \$1.63 per square feet utilized by Mr. Schwalls. On the other hand, the administrative judge would not have necessarily adopted a date of January 1, 2007 for stabilized occupancy.

Based upon the foregoing, the administrative judge finds that subject property should initially be appraised at \$1,744,100 in accordance with Mr. Middleton's income approach. However, the administrative judge finds that the indicated value should be reduced by \$128,500 in accordance with Mr. Schwalls' lease-up analysis. This results in a value of \$1,615,600.

² Tenn. Code Ann. § 67-5-502(d) provides for leasehold assessments in limited circumstances.

ORDER

It is therefore ORDERED that the following value and assessment be adopted for tax year 2006:

<u>LAND VALUE</u>	<u>IMPROVEMENT VALUE</u>	<u>TOTAL VALUE</u>	<u>ASSESSMENT</u>
\$465,000	\$1,150,600	\$1,615,600	\$646,240


It is FURTHER ORDERED that any applicable hearing costs be assessed pursuant to Tenn. Code Ann. § 67-5-1501(d) and State Board of Equalization Rule 0600-1-.17.

Pursuant to the Uniform Administrative Procedures Act, Tenn. Code Ann. §§ 4-5-301—325, Tenn. Code Ann. § 67-5-1501, and the Rules of Contested Case Procedure of the State Board of Equalization, the parties are advised of the following remedies:

1. A party may appeal this decision and order to the Assessment Appeals Commission pursuant to Tenn. Code Ann. § 67-5-1501 and Rule 0600-1-.12 of the Contested Case Procedures of the State Board of Equalization. Tennessee Code Annotated § 67-5-1501(c) provides that an appeal **“must be filed within thirty (30) days from the date the initial decision is sent.”** Rule 0600-1-.12 of the Contested Case Procedures of the State Board of Equalization provides that the appeal be filed with the Executive Secretary of the State Board and that the appeal **“identify the allegedly erroneous finding(s) of fact and/or conclusion(s) of law in the initial order”**; or
2. A party may petition for reconsideration of this decision and order pursuant to Tenn. Code Ann. § 4-5-317 within fifteen (15) days of the entry of the order. The petition for reconsideration must state the specific grounds upon which relief is requested. The filing of a petition for reconsideration is not a prerequisite for seeking administrative or judicial review; or
3. A party may petition for a stay of effectiveness of this decision and order pursuant to Tenn. Code Ann. § 4-5-316 within seven (7) days of the entry of the order.

This order does not become final until an official certificate is issued by the Assessment Appeals Commission. Official certificates are normally issued seventy-five (75) days after the entry of the initial decision and order if no party has appealed.

ENTERED this 24th day of August, 2007.



MARK J. MINSKY
ADMINISTRATIVE JUDGE
TENNESSEE DEPARTMENT OF STATE
ADMINISTRATIVE PROCEDURES DIVISION

c: Mr. Jim Schwalls
Tameaka Stanton-Riley, Appeals Manager

The administrative judge finds that the August 24, 2005 sale of subject property cannot be considered for two reasons. First, it occurred after the assessment date of January 1, 2005 and is therefore irrelevant. See *Acme Boot Company and Ashland City Industrial Corporation* (Cheatham County - Tax Year 1989) wherein the Assessment Appeals

Commission ruled that “[e]vents occurring after [the assessment] date are not relevant unless offered for the limited purpose of showing that assumption reasonably made on or before the assessment date have been borne out by subsequent events.” Final Decision and Order at 3. Second, it appears from Mr. Schwalls’ testimony that the sale price was an allocation from a transaction involving the sale of over 30 properties. As seen in other appeals heard along with this appeal, in certain instances even the assessor’s contention of value is far below the price allocated to that particular property.¹

With respect to the income approach, the administrative judge finds that the primary differences between the parties initially concerned their estimates of potential gross income. The administrative judge finds that the parties’ estimates of \$502,770 and \$524,530 establish a reasonable range. The administrative judge finds that the preponderance of the evidence supports adoption of \$515,000. The administrative judge finds such a figure recognizes both what is typical for the market and the fact 90,000 square feet was vacant on January 1, 2005.

The administrative judge finds that the other area of significant disagreement between the parties was Mr. Schwalls’ contention that a deduction of \$225,000 should be made from the stabilized indication of value to account for lost income during the lease-up period for the 90,000 square feet vacant on January 1, 2005.

The administrative judge finds that except for the one adjustment discussed below, Mr. Schwalls’ lease-up analysis comports with generally accepted appraisal practices. For example, in *Kailes v. Josephine County Assessor* (TC-MD 982945C, 000613C) the Oregon Tax Court approved a similar analysis reasoning in pertinent part at page 6 of its opinion as follows:

Lost Rent

The Appraisal of Real Estate discusses rent loss in the context of a proposed multi-tenant project that is not fully leased. In that situation, the authors note that “[t]he appraiser should account for the impact of the rent lost while the building is moving toward stabilized occupancy.” *Id.* At 590. Several approaches are set forth regarding how the appraiser can account for the loss of rent. One recommended technique is to “discount the net income loss during lease-up, which is then deducted from the value of the property at stabilized occupancy.” *Id.* Both of Plaintiff’s appraisers did just that. The amount each appraiser deducted differed because they used different lease-up periods (one year versus two). The court finds no practical reason why the same approach would not be valid for the subject building with no tenant(s), because each situation presents the same problem. The risk inherent with Plaintiff’s property is accentuated by the fact that it is a one or two tenant property.

¹ For example, Mr. Middleton contended that parcel 073-102-A00040 should be valued at \$1,698,800 based upon the income approach although it sold on August 24, 2005 for a recorded consideration of \$2,239,242.

As such, the absence of a tenant has a dramatic impact on income and, in a market with lengthy lease-ups, a significant impact on value.

As previously indicated, the administrative judge finds one adjustment to Mr. Schwalls' analysis appropriate. The administrative judge finds it reasonable to assume that the lease-up period would conclude prior to January 1, 2006. Accordingly, the administrative judge finds that the \$33,954 deduction made as of January 1, 2006 should be disallowed. This results in an estimate of lost income of \$191,043 rather than \$225,000.

Based upon the foregoing, the administrative judge finds that subject property should be valued in accordance with the following income approach:

Potential Gross Income	\$ 515,000
Less Vacancy & Collection Loss	- 51,500
Effective Gross Income	\$ 463,500
Less Operating Expenses & Reserves	- 41,537
Net Operating Income (NOI)	\$ 421,963
Cap Rate	÷ 8.25%
Indicated Stabilized Value	\$5,114,703
Less Lease-Up	- 191,043
Final Value	\$4,923,660

ORDER

It is therefore ORDERED that the following value and assessment be adopted for tax year 2005:

<u>LAND VALUE</u>	<u>IMPROVEMENT VALUE</u>	<u>TOTAL VALUE</u>	<u>ASSESSMENT</u>
\$672,900	\$4,250,800	\$4,923,700	\$1,969,480

It is FURTHER ORDERED that any applicable hearing costs be assessed pursuant to Tenn. Code Ann. § 67-5-1501(d) and State Board of Equalization Rule 0600-1-.17.

Pursuant to the Uniform Administrative Procedures Act, Tenn. Code Ann. §§ 4-5-301—325, Tenn. Code Ann. § 67-5-1501, and the Rules of Contested Case Procedure of the State Board of Equalization, the parties are advised of the following remedies:


1. A party may appeal this decision and order to the Assessment Appeals Commission pursuant to Tenn. Code Ann. § 67-5-1501 and Rule 0600-1-.12 of the Contested Case Procedures of the State Board of Equalization. Tennessee Code Annotated § 67-5-1501(c) provides that an appeal **"must be filed within thirty (30) days from the date the initial decision is sent."** Rule 0600-1-.12 of the Contested Case Procedures of the State Board of Equalization provides that the appeal be filed with the Executive Secretary of the State Board and that the appeal **"identify the allegedly erroneous finding(s) of fact and/or conclusion(s) of law in the initial order"**; or
2. A party may petition for reconsideration of this decision and order pursuant to Tenn. Code Ann. § 4-5-317 within fifteen (15) days of the entry of the order.

The petition for reconsideration must state the specific grounds upon which relief is requested. The filing of a petition for reconsideration is not a prerequisite for seeking administrative or judicial review; or

3. A party may petition for a stay of effectiveness of this decision and order pursuant to Tenn. Code Ann. § 4-5-316 within seven (7) days of the entry of the order.

This order does not become final until an official certificate is issued by the Assessment Appeals Commission. Official certificates are normally issued seventy-five (75) days after the entry of the initial decision and order if no party has appealed.

ENTERED this 10th day of October, 2006.



MARK J. MINSKY
ADMINISTRATIVE JUDGE
DEPARTMENT OF STATE
ADMINISTRATIVE PROCEDURES DIVISION

c: Mr. Jim Schwalls
Tamecka Stanton-Riley, Appeals Manager